SIFMA
Securities Industry and
Financial Markets Association

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Via Electronic Delivery

Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Department of the Treasury
Office of Critical Infrastructure
Protection and Compliance Policy
Main Treasury Building–Room 1327
Washington, D.C.

Re: Proposed Rule Implementing Unlawful Internet Gambling Enforcement Act
FRB Docket No. R-1298; Treas. Docket No. Treas-DO-2007-0015

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment to the Federal Reserve Board and the Department of the Treasury (the "Agencies") on the proposed rule to implement applicable provisions of the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act").[2] The Act requires the Agencies to promulgate regulations to (1) designate certain payment systems that could be used in connection with unlawful Internet gambling transactions, and (2) require participants in the payment systems to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit transactions in connection with unlawful Internet gambling.

The proposed rule (i) sets out definitions for various terms; (ii) designates payment systems that could be used by participants in connection with, or to facilitate, a restricted transaction; (iii) exempts certain participants in certain designated payment systems from its requirements; (iv) requires participants performing non-exempt functions in a designated payment system to establish and implement policies and procedures reasonably designed to prevent or prohibit restricted transactions, such as by identifying and blocking such transactions; (v) provides examples of policies and procedures for non-exempt participants in each designated payment system; and (vi) sets out the regulatory enforcement framework.

[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] 72 *Fed. Reg.* 56680 (October 4, 2007).

DEFINITIONS[3]

Unlawful Internet Gambling

The proposed rule provides that the term "unlawful Internet gambling" means a bet or wager involving the Internet that is unlawful under federal or state law where the bet or wager is initiated, received or otherwise made. It is not clear what types of gambling transactions over the Internet, if any, might be lawful. The Agencies have determined not to further define gambling-related terms because the Act itself does not specify which gambling activities are legal or illegal. SIFMA is concerned that if the Agencies themselves are unwilling or unable to provide additional guidance to financial institutions regarding what constitutes unlawful Internet gambling, financial institutions run the risk of both processing unlawful Internet gambling payment transactions that should not be processed and preventing transactions that are lawful. Without additional guidance, financial institutions may, out of an abundance of caution, implement procedures that identify and block *all* gambling-related transactions, including lawful transactions. Although the Act would permit such an approach since it contains a safe harbor for blocking transactions, we do not believe that was the intent of the Act. Such an approach would also take resources and focus away from other compliance efforts. Accordingly, SIFMA urges the Agencies, in conjunction with the Department of Justice and State Attorneys General, to provide additional specificity and guidance to financial institutions regarding the legal status of certain Internet gambling transactions.

Participant in a Designated Payment System

The proposed rule defines a participant in a designated payment system as an operator or a financial transaction provider that is a member of, has contracted for financial transaction services with, or is otherwise participating in, a designated payment system. The term does not include a customer of the financial transaction provider if the customer is not a financial transaction provider otherwise participating in the designated payment system on its own behalf.

The proposed rule does not provide guidance as to what constitutes a customer that is "otherwise participating in the designated payment system on its own behalf." Securities firms often originate ACH debits and credits and other payments to and from clients and counterparties. These payments are originated for the benefit of the securities firm (such as to pay for purchases of securities) as well as for the benefit of customers (such as to make a requested bill payment). In all cases, the securities firm must process the transaction through a bank at which it maintains an account. As a result, the securities firm's bank initiates the payment (such as an ACH debit) into the payment system. SIFMA believes that it is not the intent of the Act or the proposed rule to cover entities simply because they originate payments for their own benefit or the benefit of their customers because such payments are indistinguishable from payments made by other parties. SIFMA believes that the term "participant" is intended to refer to a financial transaction provider that engages in activities that constitute more than simply origination of payments for

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[3] SIFMA also wishes to point out what appears to be a technical oversight in an exception to the definition of "bet or wager." Section __.2(b)(5)(ix) of the proposed rule provides that the term bet or wager does not include "(ix) Participation in any fantasy or simulation sports game or educational game or contest in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership or an actual team that is a member of an amateur or professional sports organization . . ." (Emphasis added.) The Act, however, uses the phrase "is based on the current membership of an actual team . . ." (Emphasis added.) 31 U.S.C. § 5362(1)(E)(ix). SIFMA believes that "of" is correct.

themselves. Accordingly, SIFMA believes that the Agencies should amend the proposed rule to clarify that the definition of participant in a designated payment system does not include a customer of a financial institution provider that simply originates payments on behalf of its customers.

DESIGNATED PAYMENT SYSTEMS

The proposed rule designates five payment systems as systems that could be used in connection with unlawful Internet gambling. These systems are:

- Card systems
- Money transmitting systems
- Check collection systems
- ACH
- Wire transfer systems

SIFMA believes that the payment systems designated by the Agencies are the appropriate systems to cover under the Act and the proposed rule. SIFMA is unaware of other payment systems that could be used in connection with, or to facilitate, restricted transactions.

EXEMPTIONS

The Agencies propose to exempt all participants in ACH systems, check collection systems, and wire transfer systems, except for participants that possess the customer relationship with Internet gambling businesses. The Agencies state that exemptions for these participants reflect the fact that these systems currently do not function in a manner that enables such participants to reasonably identify and block, or otherwise prevent or prohibit, restricted transactions. SIFMA believes that given the manner in which ACH, check collection, and wire transfer systems function, participants in these systems that the Agencies propose to exempt cannot, as a practical matter, identify and block, or otherwise prevent or prohibit, restricted transactions. Accordingly, SIFMA supports the exemptions as proposed by the Agencies.

CARD SYSTEMS

The proposed rule applies to issuers of credit cards, debit cards, pre-paid cards, stored value cards or the agent of such issuers. It is not clear, however, whether a securities firm that maintains a co-branded card program with an issuer could be regarded as an agent of an issuer and therefore subject to the proposed rule. Co-branded cards are issued by a depository institution but typically include the non-depository institution's name on the card. The cards are usually issued to customers of the non-depository institution. In some co-branded card arrangements, the non-depository institution may assist the card issuer in certain aspects of the program, such as performing sub-accounting, issuing statements and providing authorization services, under a servicing contract with the card issuer. SIFMA believes that a securities firm should not be regarded as a participant in the designated card system simply because its name appears on the card or the securities firm provides services to the card issuer in support of the program. Rather, SIFMA believes that only the depository institution that issued the card should be regarded as the participant. The depository institution is the entity that is the member of the card system and is the entity that processes the transaction by interacting with the card system. Therefore, the

depository institution that issued the card is in a better position than is the non-depository institution to identify and block a restricted transaction. With respect to many co-branded debit and credit card products, the non-depository institution does not get *any* data about the transactions until after they are completed. In such circumstances, non-depository institutions cannot identify or block a restricted transaction before it occurs, and they cannot undo them after the fact. Therefore, as between the depository institution that issues the card and the non-depository institution that co-brands it, only the depository institution can identify and block a restricted transaction. Accordingly, SIFMA requests that final rule state that in connection with co-branded cards, only the depository institution that issued the card is a participant in the designated card system.

CHECK COLLECTION SYSTEM

The proposed rules apply to certain participants in check collection systems, primarily "depository banks." A depository bank is the first bank that receives a check from a customer for collection. The proposed rule states that it does not apply to a paying bank (unless the paying bank is also the depository bank), nor does it apply to a collecting bank or returning bank. A collecting bank and a returning bank would not be in a position to know for what purpose the check they are processing was written and therefore could not determine if the item represented a restricted transaction. A paying bank also could not determine the purpose of a check before the bank settled for the item. Because of the manner in which checks today are presented for payment and settled, a paying bank would not ordinarily be able to prevent in a timely fashion a restricted transaction involving a check payment. Requiring paying banks to implement procedural changes to identify and prevent restricted transactions involving checks would slow down the collection of checks and add considerably to check collection costs, which ultimately would be borne by customers. As a result, SIFMA believes the exemption for paying banks, collecting banks and returning banks is reasonable and warranted.

SIFMA believes that the Agencies should clarify the status of banks through which a check is payable. The preamble to the proposed rule states that the paying bank is generally the bank by or through which the check is payable and to which the check is sent for payment or collection.[4] However, the Uniform Commercial Code provides that if an item states that it is "payable through" a bank identified in the item, the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item. The item may be presented for payment only by or through the bank.[5] In order to avoid confusion as to the status of a payable through bank under the proposed rule, SIFMA requests that the Agencies add a bank through which an item is payable to the proposed exemption for paying banks, collecting banks and returning banks.

ACH

The proposed rule applies to participants in the ACH system that may maintain customer relationships with Internet gambling businesses. As a result, the proposed rule applies to (1) financial institutions providing ACH services to originators of ACH debits ("originating depository financial institutions," or "ODFIs"), and (2) financial institutions providing ACH services to receivers of ACH credits ("receiving depository financial institutions," or "RDFIs"). As a result, the proposed rule does not

[4] 72 *Fed. Reg.* at 56687.
[5] UCC 4-106(a).

apply to an ODFI in an ACH credit transaction, nor to an RDFI in an ACH debit transaction. SIFMA believes, however, that the final rule should also clarify that it does not apply to third party senders as well.

As indicated in the preamble to the proposed rule, a third party sender acts as an intermediary between an originator and an ODFI and, under ACH rules, assumes the responsibilities of an originator. A third party sender is also obligated to provide the ODFI with any information the ODFI reasonably deems necessary to identify the originator for which the third party sender is sending transactions. Because a third party sender acts solely as an intermediary between the originator and the ODFI and is obligated to provide the ODFI with information regarding the identity of the originator, there is little reason to regard the third party sender as a participant in the ACH system. Moreover, a third party sender for an originator of an ACH credit is in precisely the same position as an ODFI. The third party sender would be unable to determine if the transaction is a restricted transaction, nor would it be able to evaluate whether the originator's characterization of the transaction is accurate. As a result, just like an ODFI, a third party sender is not in a position to reasonably implement policies and procedures to identify and block ACH credits that may represent restricted transactions. Accordingly, SIFMA requests that the Agencies conclude that a third party sender of ACH transactions also is exempt from the proposed rule.

WIRE TRANSFER SYSTEMS

The proposed rule applies to certain participants in wire transfer systems such as Fedwire and the Clearing House's CHIPS systems. An institution that is a beneficiary's bank (*i.e.*, the institution receiving the wire transfer on behalf of the Internet gambling business) is covered by the proposed rule because it is the entity that has the customer relationship with the Internet gambling business. A depository institution that is not a beneficiary's bank is exempt from the proposed rule. SIFMA believes that the rationale that justifies the exemption for ODFIs in ACH credit transactions is also applicable to the originator's bank and to the intermediary bank. SIFMA believes that the provisions of the proposed rule relating to participants in wire transfer systems is appropriate. Accordingly, SIFMA supports this portion of the proposed rule.

While it may be possible for an originating bank to obtain information from its customer as to the purpose of the payment, the bank is not in a position to verify the accuracy of the statement. Accordingly, it is not reasonably practical for an originator's bank and an intermediary bank in a wire transfer system to implement policies and procedures that would likely be effective in identifying and blocking or otherwise prevent or prohibit restricted transactions.

MONEY TRANSMITTING SYSTEMS

The proposed rule applies to all participants in money transmitting businesses. Because money transmitting systems operate in several different ways, SIFMA is concerned that the proposed rule may be overly inclusive. SIFMA believes that the Agencies should apply the proposed rule to all participants in money transmitting systems only if the system is a closed system, that is, only if the operator of the system originates, processes and receives the payment on behalf of the beneficiary. If the system is an open system that involves other participants, SIFMA strongly believes that the principles underlying the exemptions for check, ACH and wire systems should apply equally to money transmitting systems.

LIST OF UNLAWFUL INTERNET GAMBLING BUSINESSES

The agencies considered and rejected the possibility of devising a list of unlawful Internet gambling businesses due the difficulty of determining which businesses should be on the list. Nonetheless, the Agencies have requested comment on whether the development of such a list is appropriate. SIFMA strongly believes that a government prepared list of unlawful Internet gambling businesses, similar to the Office of Foreign Asset Control ("OFAC") list that the Treasury Department prepares and maintains, would prove extremely useful in participants' efforts to comply with the final rule. Accordingly, SIFMA requests that the Agencies prepare and maintain a list of businesses that are engaged in unlawful Internet gambling.

POLICIES AND PROCEDURES

The proposed rules provide non-exclusive examples of policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions for each of the designated payment systems. While many of the examples mirror "know your customer" procedures financial institutions already apply, several appear to impose considerable burdens on financial institutions subject to the rule. For example, requiring periodic confirmation by participants of the nature of their customers' businesses would be excessively intrusive and highly burdensome to financial institutions. In addition, requiring certain designated payment systems to conduct ongoing monitoring and testing may prove cumbersome and overly burdensome. SIFMA agrees that such testing and monitoring should not apply to ACH, check and wire systems because of the open nature of these systems.

BLOCKING TRANSACTIONS

The Act provides that the Agencies should ensure that the rule should not block or otherwise prevent transactions that are not unlawful Internet gambling transactions. The Agencies have observed that certain payment systems and participants have decided for various reasons not to process any gambling transactions. Accordingly, the Agencies have requested comment on whether the Act authorizes the Agencies to require designated payment systems to process transactions that are not restricted. SIFMA agrees with the Agencies that the Act does not authorize them to require payment systems to process gambling transactions. The Act requires the Agencies only to ensure that the proposed rule does not block or otherwise prevent transactions in connection with lawful Internet gambling. SIFMA believes that the Act does not alter the authority of payment systems and participants to determine as a business matter what transactions they wish to process.

EXEMPTION FROM LIABILITY

The proposed rule states that a person that identifies and blocks a transaction, prevents or prohibits the acceptance of its products or services in connection with a transaction, or otherwise refuses to honor a transaction, shall not be liable to any party for such action if (1) the transaction is a restricted transaction; (2) such person reasonably believes the transaction to be a restricted transaction; or (3) the person is a participant in a designated payment system and blocks or otherwise prevents the transaction in reliance on the policies and procedures of the designated payment system in an effort to comply with this regulation. § __.5(c). The language of the Act, however, extends the protection afforded in (3) above as well to

designated payment systems. *See* 31 U.S.C. §5364(d)(3). In order to assure the maximum protection from liability and to avoid the possibility of any ambiguity as to the scope of the exemption from liability, SIFMA requests that the Agencies adopt the language of the Act.[6]

In addition, SIFMA believes that the Agencies should indicate that 31 U.S.C. § 5364(d) and the provision of the rule that is based upon this provision will exempt a person that meets the requirements of the section from contractual liability to any party as well. A person that relies upon this provision of the Act and the Agencies' rule should not have itself be exposed to potential litigation as to the meaning and scope of the Act and the rule.

DUE DILIGENCE

The Agencies indicate that the due diligence requirements for a participant establishing a customer relationship in an ACH system also apply to the establishment of a relationship with any third-party sender. According to the Agencies, a third-party sender should conduct due diligence on its customers to ensure that it is not transmitting restricted transactions through an ODFI, and the ODFI should confirm that the third-party sender conducts such due diligence on its originators. SIFMA agrees that it is appropriate for participants to incorporate the due diligence provisions into their existing account-opening procedures.

The Agencies further indicate that in maintaining the customer relationship with the third-party sender, the participant should ensure that there is a process to monitor the operations of the third-party sender, such as by audit. SIFMA believes that the Agencies should permit participants to treat third party senders in the same manner they treat originators and leave it up to them to determine how they will conduct due diligence on third-party senders. SIFMA sees no reason for the Agencies to suggest that a participant monitor the operations of a third-party sender by such means as an audit. In addition, SIFMA believes it is not necessary nor appropriate for the proposed rule's examples of due diligence methods to explicitly include periodic confirmation by the participants of the nature of their customers' business. Such a requirement would appear overly rigid and impose a considerable burden on participants without significant benefit.

EFFECTIVE DATE

The agencies propose to make the rule effective six months after it is finalized. SIFMA believes that six months is insufficient time in which to implement the operational and procedural changes that the final rule will require as well as to train affected staff. SIFMA believes that at least eighteen months is needed for designated payment systems and participants to adopt policies and procedures and effect the necessary operational changes, including modification of systems and software to prevent or prohibit restricted transactions, such as by identifying and blocking such transactions. Accordingly, SIFMA recommends that the final rule become effective no earlier than eighteen months after it is finalized.

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[6] While § __.5(a) uses the phrase "[a]ll non-exempt participants in designated payment systems" to specify the entity covered by the proposed rule, § __.5(b) uses the phrase "[a] non-exempt financial transaction provider participant in a designated payment system." SIFMA believes that the Agencies should use one term to avoid any possibility of confusion as to coverage of the rule.

SIFMA appreciates the opportunity to provide its comments to the Agencies on the proposed rule to implement the Act. We hope that our comments will assist the Agencies in connection with their consideration and adoption of a final rule. If you have any questions, please contact the undersigned at (202) 962-7300.

Sincerely,

Alan E. Sorcher
Managing Director and
Associate General Counsel